SINGAPORE'S FY2003 BUDGET:

Fine Tuning Fiscal Policy Amid Mixed Economic Signals

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S U M M A R Y

The Singapore Government's FY2003 (April 1, 2003 to March 31, 2004) budget estimates revenue of S$29.6 billion (US$16.8 billion) and expenditure of S$29.9 billion (US$16.9 billion, or 19.2% of nominal GDP), plus additional special transfers of S$600 million (US$340 million). The overall budget expects a deficit of S$900 million (US$509 million) for FY2003, ten times the estimated FY2002 deficit of S$90 million (US$50.9 million). Deputy Prime Minister/Finance Minister Lee Hsien Loong stressed that the Government has not changed its longstanding prudent fiscal policy and that the modest deficit is appropriate given the weak economy. Most analysts expect government spending to be higher (and revenue lower) than forecast, given that the economic outlook has worsened since the budget was originally unveiled.

The FY2003 budget does not include any dramatic policy initiatives and also does not, as many had expected, reduce corporate or personal tax rates further, although the Government says it remains committed to reducing rates to 20 percent by FY2004 (rates were reduced to 22 percent last year). Officials assert that critics should not look at the Budget in isolation but rather see it as part of the economic restructuring initiatives launched with the FY2002 budget and also contained in final report of the Government's Economic Review Committee (ERC), issued prior to the unveiling of the FY2003 budget. A large portion of the proposed changes are targeted at nurturing entrepreneurship and developing the services sector: building an intellectual property hub in Singapore, promoting private wealth management, and reinforcing Singapore's role as a global trading and marine hub.

The most significant statement in the Budget announcement may be DPM Lee's comments on the Government's divestment plans and the Government's role in the economy. In his budget speech, Lee said the Government will not set up new companies, except in areas where the private sector is not ready, or where the business is strategic to the country's well-being. The Government has started a review of all their existing companies to be divested. The Government will also stop providing services that the private sector can supply. A Ministerial Committee on Services, which DPM Lee will chair, will be set up "to coordinate policy and make necessary trade offs."

Since the budget was unveiled and the 2003 fiscal year began on April 1, Singapore's economic outlook has deteriorated, largely due to the effects of the SARS virus. A sharp fall in visitor arrivals, coupled with a decline in retail sales, are likely to depress tax revenues below the level initially forecast in February. Likewise, emergency government spending on responding to the SARS virus, including relief measures for affected sectors of the economy, is boosting expenditure. For example, in April the Government announced a special S$230 million "SARS Relief Package," and most analysts expect the Government to supplement this further.

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http://singapore.usembassy.gov/ep/reports_2003.shtml

More detailed data on the FY2003 Budget can also be found at: http://www.budget2003.gov.sg/

THE MACRO VIEW

The FY2003 Budget is based on estimated operating revenue of S$29.6 billion (US$16.8 billion) and operating expenditure of S$29.9 billion (US$16.9 billion), with an estimated deficit of S$900 million (US$509 million). The deficit is due to higher development spending -- S$9.56 billion (US$5.4 billion), up 22% over the S$7.83 billion (US$4.4 billion) in FY2002 -- and also to S$600 million (US$340 million) under 'special transfers' for 'economic restructuring shares'. The allocation for special transfers represents a decline of 67% compared to the previous year. Analysts see these shifts as a move by the Government to create multipliers for the economy through infrastructure development rather than to give direct handouts to the population.

In a February 23 statement outlining the budget, DPM Lee said that while the S$900 million (US$509 million) deficit will act as a stabilizer to steer the economy towards the path of recovery, the Government is committed to maintaining a balanced Budget and to accumulating a modest budget surplus over the longer-term. The Budget deficit in FY2003 is the Government's third consecutive deficit since FY2001, but the deficit from the previous two years stemmed from special transfers to provide an off-budget stimulus for businesses and households. Without the special transfers, the FY2002 Budget would have a surplus of S$1.71 billion (US$968 million).

OFFSET PACKAGE

The FY2003 Budget has some direct "handouts" for businesses and individuals, which are intended to help offset the pain of economic restructuring. The measures include rebates for Singaporeans living in publicly-constructed housing, direct assistance to the lowest income Singaporeans and the allocation of 'Economic Restructuring Shares', a scheme involving bond-like instruments which can be held to accrue interest or sold for cash. The budget also provides for exemption of stamp duty on leasing or purchasing of low-income public housing, and leases with annual rentals of less than S$1,000 (US$566).

OUTLOOK: MORE SPENDING, LOWER RVENUE AHEAD

Given that the economic outlook has worsened since the budget was introduced in late February, most analysts expect spending to be higher than budgeted, as the Government introduces additional off-budget measures, such as tax and fee rebates, to offset the negative effects of the SARS (Severe Acute Respiratory Syndrome) outbreak on economic activity in Singapore. For example, in April the Government unveiled a special S$230 million "SARS Relief Package" including rebates and cuts in fees and service charges for various SARS-affected sectors. Likewise, the operating revenue forecast contained in the budget may prove optimistic, given the sharp SARS-induced fall in visitor arrivals and other travel-related business, coupled with a decline in retail sales. The net result is that, while spending will be higher than forecast, revenues are likely to be below the level initially forecast in February.

THE NUMBERS

Table: FY2003 Budget

	(S$ Billion)			
	Est. FY2002	Revised FY2002	Est. FY2003	% Change over FY 2002 Revised
Operating Revenue	29.21	29.07	29.62	1.9
Tax Revenue	22.90	21.11	22.05	4.4
Fees & Charges	3.80	4.02	4.49	11.7
Net Investment Income Contribution	2.39	3.81	2.29	-21.6
Others	0.12	0.13	0.10	-25.2
Less:				
Total Expenditure	28.33	27.36	29.92	9.4
Operating Expenditure	19.54	19.52	20.36	4.3
Development Expenditure	8.79	7.83	9.56	22.0
Surplus	0.89	1.71	-0.30	-117.5
Less:				
Special Transfers	0.00	1.81	0.60	-66.8
Economic Restructuring Shares	0.00	1.20	0.60	-50.0
CPF Top-Up Scheme	0.00	0.50	0.00	-100.0
Lifelong Learning Endowment Fund	0.00	0.10	0.00	-100.0
Medical Endowment Fund	0.00	0.01	0.00	-100.0
BUDGET SURPLUS/DEFICIT	0.89	-0.90	-0.09	854.8

Revenue

In its presentation on the budget, the Government stated it expects higher tax and fee receipts in FY2003 than FY2002 due to improved economic conditions and revisions in the systems for fees and rebates. Tax revenue is estimated to increase by 4.4% due to higher expected collections all round, including:

- Goods & Services Tax (GST). The increase in the GST from three to four percent on January 1, 2003 is expected to increase revenues by S$800 million (US$453 million).
- Property taxes. Expected to increase by S$1.62 billion (US$917 million), due to the replacement of a new rebate system for commercial and industrial properties effective July 1, FY2003, and the termination of the remission for land in October FY2003.

- Motor vehicle taxes. Revenues are expected to rise by S$1.99 billion (US$1.13 billion) due to a reduction in certain tax rebates, and by S$470 million (US$266 million), due to and increase in the number of car entitlement certificates issued.

Composition of estimated tax revenue for FY2003:

	S$ Billion	% Share
Direct Tax		
Corporate & Personal Income	10.4	47.3
Assets Tax	1.7	7.7
Indirect Tax		
Goods & Services Tax	3.0	13.6
Customs & Excise Tax	1.7	7.7
Motor Vehicle Tax	2.0	9.1
Betting Taxes	1.5	6.8
Stamp Duty	0.7	3.2
Others	1.0	4.5
Total	22.0	100.0

Revenue from direct taxes is forecast to decline by 4.8% to 55% of total estimated taxes for FY2003, in tandem with the Government's plan to shift Singapore's tax regime to depend less on direct taxes. Only a third of working adults in Singapore pay income tax at present. With the shift to a less progressive tax system, the Government hopes to reduce the tax burden on those in higher-income brackets, while gradually raising the share of total tax revenue contributed by indirect taxes to 50%.

Expenditure

The FY2003 budget pegs expenditure at S$29.9 billion (US$16.9 billion), an increase of 9.4% from that of FY2002, and equivalent to about 19.2% of CY2002 nominal GDP. The Government aims to keep expenditure below 20% of GDP. Major ministries and their budget allocations follow:

- Defense: 27.7% of the budget, the largest allocation, accounting for 5.3% of FY2002 nominal GDP. The Government justifies the high level of spending by saying a robust defense capability is necessary to deter potential external threats.

- Education: 21.7%, representing 4.2% of FY2002 nominal GDP. Currently, Singapore has 660,000 students in its formal education system. The Government is investing heavily in the country's principal natural resource, .

- National Development: 8.4%, receiving the largest increase, as the Government steps up land reclamation, infrastructure development and renewal of older public housing.

- Health: 7.0%, of which nearly S$1.2 billion (US$679 million) will be spent on subsidized healthcare at public hospitals and voluntary welfare organizations.

- Trade & Industry: 6.7%, of which S$2.8 billion (US$1.6 billion) goes toward enhancing R&D and industrial capabilities.

- Transport: 4.7%, mainly for new highway and subway construction.

Table: FY2003 Expenditure By Sector and Ministry

	S$ Billion	% Share	% Change from FY2002
TOTAL EXPENDITURE	29.9	100.0	9.4
Social Development	13.9	46.5	15.6
Education	6.5	21.7	-1.8
National Development	2.5	8.4	70.0
Health	2.1	7.0	33.9
Environment	1.5	5.0	21.6
Community Development & Sports	0.8	2.7	9.6
Information, Communications & theArts	0.5	1.7	20.9
Security/External Relations	10.9	36.4	3.0
Defense	8.3	27.7	0.6
Home Affairs	2.3	7.7	13.6
Foreign Affairs	0.3	1.0	-1.3
Economic Development	3.7	12.4	8.7
Transport	1.4	4.7	-6.9
Trade & Industry	2.0	6.7	24.3
Manpower	0.2	0.7	-2.5
Info-Communications Technology	0.1	0.3	49.6
Government Administration	1.4	4.7	4.9
Finance	0.6	2.0	19.9
Law	0.3	1.0	-35.9
Organs of State (*)	0.3	1.0	38.6
Prime Minister's Office	0.2	0.7	17.2

** includes the President, Parliament and Judiciary*

KEY FISCAL CHANGES

The FY2003 budget contains relatively few new fiscal initiatives, at least compared to the FY2002 budget. The Government states that the new initiatives total S$324 million (US$183 million). These include changes to taxes, exemptions and allowances for various business and individuals proposed in line with the ERC's recommended strategies for nursing the economy back to health: enhancing competitiveness and flexibility, nurturing entrepreneurship, promoting manufacturing and services as twin engines of growth and investing in human capital.

Competitiveness/Flexibility

The ERC aims to put Singapore ahead of most Asian countries in tax competitiveness by reducing corporate and income tax rates to 20%. In FY2002, the corporate tax rate was reduced to 22% while the top marginal personal income tax rate was cut to 22%. Although there are no reductions in corporate and personal income tax rates for FY2003, the Government says that rates will be reduced to 20% by FY2005.

Other salient measures proposed by the FY2003 Budget to boost Singapore's competitiveness include:

- A tax exemption for companies (including non-resident companies) and individuals for all foreign income in the form of dividends, branch profits and services income. Takes effect June 1, 2003, and applies only to income earned from jurisdictions with tax rates of at least 15%. All other foreign income will continue to be subject to the existing tax credit system.

- An increase in the ceiling for the tax exemption for interest income from local deposit accounts, through December 31, 2004. The ceiling will be removed completely on January 1, 2005.

- The employers' contribution to their staff/workers' Central Provident Fund (retirement fund) accounts will be capped at 16% until economic conditions improve.

Entrepreneurship

The budget contains a number of measures intended to stimulate entrepreneurship:

- Approved overseas companies will be allowed to defer income taxes for two years if they incur operating losses during the first three years of their investments.

- Changes to the Companies Act will be made to permit the establishment of limited liability partnerships, to allow private companies the option to appoint or outsource professionally qualified company secretaries, as well as to exempt companies with less than $2.5 million turnover from the requirement to file audited accounts.

In his budget statement, DPM Lee announced a regular review of Government rules and regulations to minimize or remove red tape to reduce business costs. He also announced the formation of a pro-enterprise panel comprising high-level Government officials and the appointment Minister of State for Trade & Industry, Raymond Lim, to head the Entrepreneurship 21 Ministerial Committee.

In an announcement welcomed by many, Lee stated that Government ministries and statutory boards will not establish new commercial ventures/companies, except in strategic areas or where the private sector is not ready. The decision does not, however, appear to apply to government-linked companies under Temasek Holdings, the Government's main holding company.

Manufacturing & Services

The FY2003 Budget proposes a number of measures that are intended to stimulate the further development of the manufacturing and services sectors:

- Tax deduction for the cost of patenting an invention, provided the legal and economic ownership of the invention belongs to the Singapore company.

- Tax exemption, for a limited five year period, on foreign-source royalties and interest income used for R&D purposes.

- Exemption from withholding tax for 10 years for payments made by end-users to non-residents for information and digitized goods.

- Provision of a capital allowance on equipment that is used by subsidiaries outside Singapore under the new "Integrated Industrial Capital Allowance", effective March 1, 2003.

- Extension of land leases for industrial use from the current 30-year lease to 60 years to enable investors to claim tax deductions for the upfront land premium for leases beyond 30 years.

- Extension of the income tax exemption to include foreign trusts administered by any trust company in Singapore, and not just those administered by approved trustee companies.

- Expansion of the Approved Marine Hull and Liability Insurer Scheme to cover both onshore and offshore marine hull and liability insurance business. Income earned by an approved insurer from writing marine hull and liability insurance is tax exempt for a 10-year period. The change is intended to boost Singapore's effort to become a marine insurance hub.

- Exemption from GST for third party logistics companies when they import goods belonging to foreign principals or to approved customers, effective January 1, 2004.

- Exemption from withholding tax for the use of capacity on submarine cables operated by non-resident persons, effective February 28, 2003 for a five-year period.

- Tax holiday for the Singapore Commodity Exchange rolled-over for another five-year period.

The Budget announces the setting up of a new Ministerial Committee on Services, to be chaired by the Finance Minister, to develop the service sector.

Human Capital

The Budget proposes the following measures to upgrade the country's human capital:

- Establishment of a statutory agency under the Ministry of Manpower to coordinate continuing education and training for adults and to oversee the training and placement of unemployed workers.

- Reduction in employees' CPF contribution from age 50, from 20% to 18%, effective January 1, 2004. The change is intended to prepare workers for the phase-out of the seniority-based wage structure.

- Increase in the tax deduction for employees' medical expenses (to two percent of the total remuneration of employees) if the employers join one of the two new medical schemes, i.e., the Portable Medical Benefits Scheme or the Transferable Medical Insurance Scheme. Those who do not participate in the schemes will be able to claim only a one percent deduction.

- Extension of tax relief to persons who take up courses, seminars or conferences which are not related to their present jobs, if they are preparing for possible career shifts.

- Increase in the ceiling for the tax deduction for employers that hire overseas professionals, from S$150,000 to S$270,000 (US$84,890 to US$152,800).

Other Taxes

- Increase in taxes on tobacco, to discourage smoking.

- Revision/rationalization of taxes on liquors, as part of bilateral free trade agreements between Singapore and key trading partners.

- Change to base the motor vehicle tax on the WTO Customs Valuation methodology, which is the CIF value of the vehicle.

REACTIONS AND EFFECTS

Most analysts did not expect any radical new initiatives from the budget, but most were surprised about the lack of stimulus for domestic consumption given the deflationary tendency of the economy in the fourth quarter of CY2002. The greatest complaint has been the absence of a further intermediate cut in the corporate tax rate. Many observers had expected at least a one percentage point cut, in the face of uncertain economic conditions. There were complaints that a bigger stimulus would be appropriate, given the large budget surpluses built up in good years.

The Monetary Authority of Singapore's Macroeconomic Review pointed out that the measures were aimed at cutting costs rather than fueling spending. The Review said the effect of the Government's package of off-Budget measures implemented in FY2002 was to boost GDP growth by one percentage point, and the effect will be greater in the medium term. Officials stress that the Budget should be seen in connection with the ERC report and its recommendations for restructuring the economy.

The subsequent two-week debate in Parliament over the Budget was focused on the painful problem of structural unemployment among the over-40s, whether the measures to promote entrepreneurship and job creation were enough, and cost impediments to doing business in Singapore.